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Lehman Net Income Declines 57%, Less Than Estimated (Update4)

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-- Lehman Brothers Holdings Inc., the fourth-biggest U.S. securities firm, reported earnings that beat analysts' estimates and reassured shareholders that it has more than enough capital to survive.

Lehman surged as much as 41 percent in New York trading, erasing yesterday's record decline. First-quarter net income fell 57 percent to \$489 million, or 81 cents a share, the New York-based company said in a statement today. Analysts had estimated Lehman would earn 72 cents a share.

Chief Executive Officer Richard Fuld is trying to persuade clients and creditors that Lehman will avoid the fate of Bear Stearns Cos., which ran out of cash last week and was forced to sell itself to JPMorgan Chase & Co. at a fire-sale price. Lehman had \$30 billion of cash and \$64 billion in assets that could easily be turned into cash as of yesterday, Chief Financial Officer Erin Callan said on a conference call with analysts.

``Surprisingly, they've taken few hits," said Carlos Mendez, who helps manage \$14 billion at Institutional Credit Partners in New York, including credit-default swaps on Lehman debt. ``That didn't happen by mistake. That is prudent risk management."

Earnings were depressed by a \$1.8 billion writedown caused by the slump in the mortgage market. Reducing the value of those assets pushed fixed-income revenue 88 percent lower, to \$262 million. Equities revenue rose 6 percent to \$1.4 billion, and merger advisory fees climbed 34 percent to \$330 million. Investment-management revenue jumped 39 percent to \$968 million.

Revenue Declines

Total revenue fell 31 percent \$3.5 billion. Return on equity, a measure of how effectively the firm invests its capital, was 8.6 percent, down from 24 percent a year earlier.

Goldman Sachs Group Inc., the world's biggest securities firm, also reported earnings that beat analysts' estimates. Profit at the New York-based firm fell 53 percent to \$1.51 billion, or \$3.23 a share. Analysts had predicted \$2.59.

Goldman Chief Financial Officer David Viniar said he is ``totally confident" in Lehman's ability to weather the current financial crisis.

“We think they're a very, very good firm and we think they will continue to be,” Viniar said in an interview today. “They're a good, healthy competitor.”

Lehman rose \$12.39 to \$44.14 in New York Stock Exchange composite trading at 11:34 a.m. Goldman, which fell 3.7 percent yesterday, gained 13 percent to \$171.13.

Fed Plan

Mendez at Institutional Credit said securities firms' cash holdings have become less important now that the Federal Reserve has agreed to let brokers borrow from its so-called discount window directly.

“These guys can fund themselves,” Mendez said.

Fuld, 61, has announced plans to cut 5,300 jobs, or 19 percent of the workforce, and closed mortgage units during the past seven months, initiatives designed to help Lehman grow faster than its peers once markets recover. He also has expanded in Europe and Asia to gain market share in stock trading.

The firm now ranks as the largest trader on the London Stock Exchange and Euronext. Lehman has risen to fourth from sixth on the New York Stock Exchange and Nasdaq. Its share of U.S. bond trading has increased by 1 percentage point to 12 percent.

“Lehman is not Bear,” Deutsche Bank AG analyst Mike Mayo said in a report yesterday. “It has more liquidity. It has support among its major counterparties. Its franchise is more diversified.”

Discount Window

Fed officials were instrumental in pushing through the JPMorgan deal for Bear Stearns as part of an effort to halt the erosion of confidence in financial firms. The central bank simultaneously announced that it would allow brokers to borrow from its discount window, typically open only to commercial banks, and would accept securities as collateral.

The Fed's action “takes the liquidity issue for the entire industry off the table,” Fuld said in a statement yesterday.

Lehman's stockpile of cash, money-market instruments, corporate bonds and equities available for sale is the largest among the five biggest brokers, according to Sanford C. Bernstein & Co. analyst Brad Hintz.

Lehman, the biggest underwriter of mortgage-backed bonds last year, owned \$80 billion of the assets at the end of November. Half were tied to commercial mortgages. Prices on those securities have declined from 2 percent to as much as 19 percent in the past three months. About \$5.3 billion of the holdings were backed by loans to subprime borrowers

at greatest risk of default. Lehman limited its writedowns to \$1.5 billion last year by using financial hedges.

Commercial Mortgages

Commercial mortgage-related assets caused \$700 million of the writedowns last quarter, Lehman said. An additional \$800 million came from residential home loans and securities tied to them. The leveraged loan portfolio had a \$500 million valuation reduction.

When the leveraged loan market recovered briefly in the fourth quarter, Lehman sold almost two-thirds of its holdings, reducing the risk of losses when prices retreated again this year.

Years of diversification have helped Lehman weather the storm, Wachovia Corp. analyst Doug Sipkin said.

“Positives are diversity,” Sipkin said in a note to investors today. “Lehman is not a fixed-income shop. Equity trading, banking and asset management accounted for 93 percent of revenues.”

Counterparty Risk

Investors may pay less attention to earnings prospects and focus instead on any signs customers and trading counterparties are sticking with the firm, or moving elsewhere, analysts said.

“After what happened to Bear, I don't think you can say with absolute certainty that it can't continue to happen,” said Peter Sorrentino, a Cincinnati-based money manager at Huntington Asset Advisors, which oversees \$15 billion and owns shares of JPMorgan and Goldman. “Could Lehman go the same way as Bear? I hate to think of it.”